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No. 415

In the Supreme Court of the United States

OCTOBER TERM, 1944

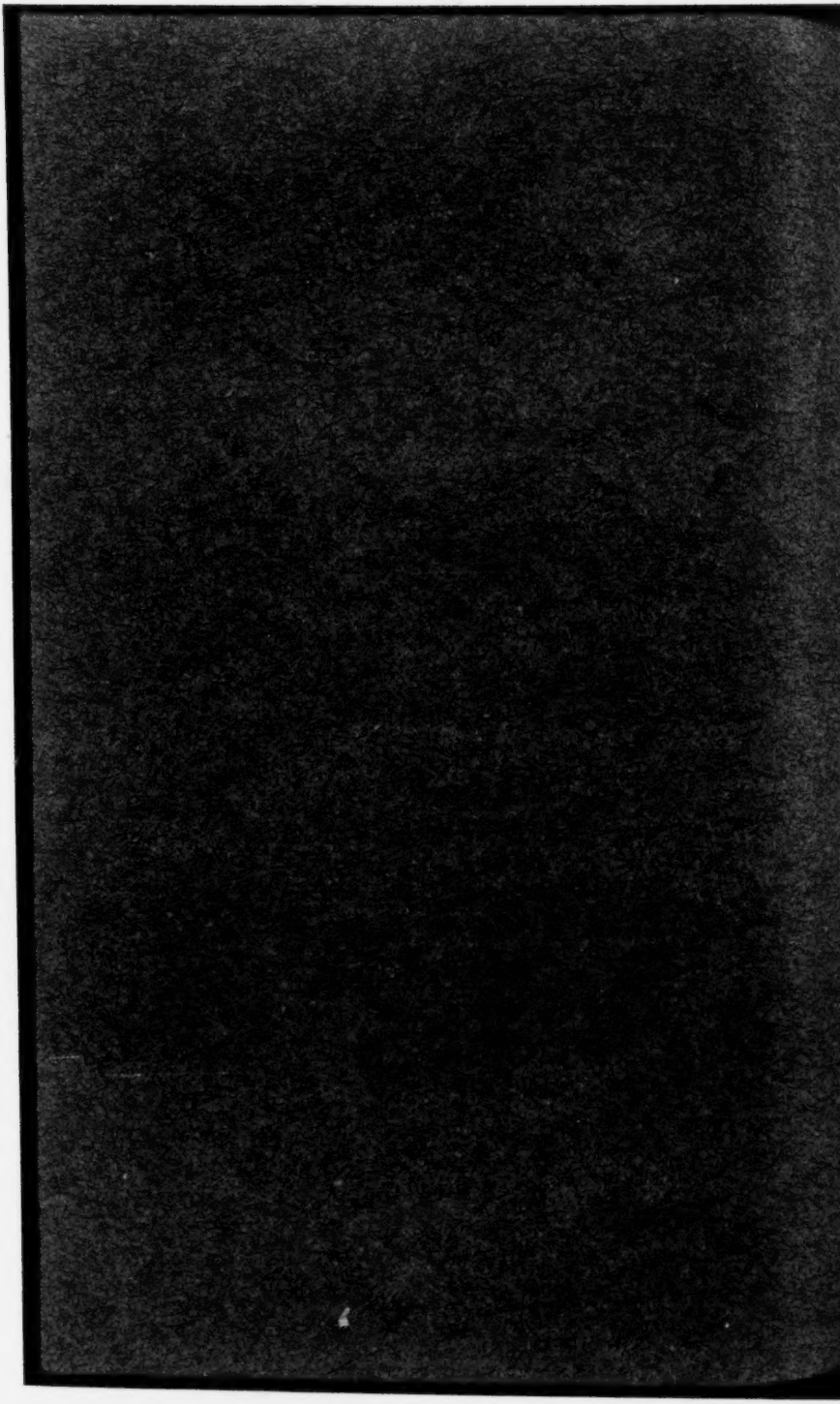
WALTER WANGER PICTURES, INC., A CORPORATION,
PETITIONER

v.

ETHEL STERLING ROGAN, AS EXECUTRIX OF THE
ESTATE OF NAT ROGAN, DECEASED

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION



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OPINIONS BELOW

The memorandum opinion of the district court (R. 64–67) is unreported. The opinion of the circuit court of appeals (R. 189–194) is reported in 143 F. 2d 459.

JURISDICTION

The judgment of the circuit court of appeals was entered on June 26, 1944 (R. 195). The petition for a writ of certiorari was filed on August 30, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a contract provision, which requires taxpayer to apply the gross receipts from an earmarked part of its assets for the discharge of an obligation to a creditor, "expressly deals with the disposition of the earnings and profits of the taxable year" within the meaning of Section 26(c)(2) of the Revenue Act of 1936, entitling taxpayer to a credit thereunder.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The tax years concerned are 1936 and 1937. The Commissioner determined a deficiency in income taxes for the year 1936 in the amount of $17,296.81 and an overassessment for 1937 in the amount of $3,148.59. (R. 189.) In making both computations the Commissioner refused to allow credits asserted by taxpayer under Section 26 (c) (2) of the Revenue Act of 1936,[1] and its claims for refund based on the denial of such credits were rejected. The basis of taxpayer's contention was the payment in 1936 to Jay Paley, one of its debtors, of $82,522.57 and in 1937 of $12,186.10. (R. 189–190.) Taxpayer is in the business of producing motion-picture films. Paley had been one of its original organizers, its president and a stockholder, and

[1] Appendix, *infra*, pp. 12–13.

elected to disassociate himself from the corporation (R. 17–32, 39). Taxpayer had produced two pictures, entitled "The President Vanishes" and "Private Worlds." In March 1935 taxpayer made a written agreement with Paley (R. 36), acknowledging his—

> right to receive from the proceeds of "The President Vanishes" and "Private Worlds" the moneys which he had loaned to said corporation, to-wit, $151,017.44,[2] * * * and also the sum of $350,000.00 representing the amount to be paid for the redemption and retirement of the preferred stock issued to the Paleys, with interest thereon at the rate of five (5%) per cent per annum from October 13th, 1934.

To carry out these terms there was concurrently executed an assignment by taxpayer to a bank as trustee (R. 35), of (R. 41)[3]—

> all gross receipts which the undersigned corporation is and/or will be entitled to receive from Paramount Productions, Inc., derived from the distribution of those

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[2] This sum had been advanced by Paley and used for the completion of these two pictures (R. 35, 39–40).

[3] In acknowledging this assignment, Paramount Productions, Inc., the distributor, consented (R. 50–51) "to pay to the Bank, its successors and assigns, and until the amount of indebtedness in said instrument referred to shall have been paid in full, all money, revenue, income, compensation and profits in connection with said two photoplays, which would otherwise be payable to said Walter Wanger Productions, Inc., out of said two photoplays, * * *."

> two certain photoplays entitled, "The President Vanishes", and "Private Worlds", * * *.

Paley agreed to look solely to the proceeds from these two photoplays for payment (R. 37). The agreement with Paley recites that taxpayer had undertaken to produce additional photoplays to be distributed by Paramount Productions, Inc., "now being made by it" (R. 36), under which taxpayer was also entitled to certain receipts (R. 36–37).[4] All the gross receipts of taxpayer derived from the release of these two pictures were paid to the bank for Paley, amounting in 1936 and 1937 to the sums already stated (R. 189).

The district court held in favor of taxpayer in an action brought for refund of the taxes paid, as a consequence of the denial of the claimed credit (R. 80). On the Government's appeal, the circuit court of appeals held that the refund should not have been allowed, and reversed (R. 194).

ARGUMENT

We submit that the decision below is correct, that there is no conflict with the decision of another circuit court of appeals on the same matter, and that no question of importance for the future administration of the tax laws is raised which should be settled by this Court.

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[4] The record further indicates receipts in February 1936, of profits earned to December 28, 1935, on other photoplays (R. 115–116), as well as other sources of income possessed by taxpayer.

1. The contract provision, which merely required taxpayer to apply the gross receipts from an earmarked part of its assets for the discharge of the obligation to Paley, does not "expressly" deal "with the disposition of the earnings and profits of the taxable year" within the meaning of Section 26 (c) (2) of the Revenue Act of 1936,[5] and taxpayer is clearly not entitled to a credit thereunder. Repeatedly it has been held, in accordance with the ruling of the court below (R. 191), that this section, since it grants a special deduction or exemption from a generally imposed surtax,[6] must be strictly construed (*Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, 49; *Nevada-Massachusetts Co.* v. *Commissioner,* 128 F. 2d 347, 348 (C. C. A. 9th); *Commissioner* v. *Oswego Falls Corp.,* 137 F. 2d 173 (C. C. A. 2d)); and since it is a special credit in the nature of a deduction, taxpayer must sustain the burden of showing compliance with its exact terms. (*Helvering* v. *Ohio Leather Co.,* 317 U. S. 102, 106; *White* v. *United States,* 305 U. S. 281, 292; *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, 440; *Buffalo Slag Co.* v. *Commissioner,* 131 F. 2d 625, 626 (C. C. A. 2d)). Thus, taxpayer is not entitled to a credit under this statute by a showing that its contract requires payments to be made out of net proceeds from a particular source and

[5] Appendix, *infra*, pp. 12–13.

[6] Revenue Act of 1936, Sec. 14, Surtax On Undistributed Profits, Appendix, *infra*, p. 12.

also other moneys (*Nevada-Massachusetts Co.* v. *Commissioner, supra*), and contracts requiring payments of stated amounts, or of amounts measured by the number of units of a commodity sold or produced, or of amounts measured by a percentage of bonds outstanding, do not expressly deal with the disposition of earnings and profits of the taxable year. (*C. C. Clark, Inc.* v. *United States,* 126 F. 2d 292 (C. C. A. 5th); *Helvering* v. *Moloney Electric Co.,* 120 F. 2d 617 (C. C. A. 8th), certiorari denied, 314 U. S. 682; *Clover Splint Coal Co.* v. *Commissioner,* 130 F. 2d 52 (C. C. A. 3d), certiorari denied, 317 U. S. 685; *Helvering* v. *Magnus Beck Brewing Co.,* 132 F. 2d 379 (C. C. A. 2d), certiorari denied, 319 U. S. 749; *Commissioner* v. *Saginaw & Manistee L. Co.,* 133 F. 2d 755 (C. C. A. 7th)).

The contract relied on here, moreover, does not deal with earnings and profits of taxpayer at all, but only with the gross receipts from two specified pictures which are earmarked for the purpose of paying a particular obligation, to whose proceeds the creditor agrees solely to look for repayment. Indeed, as the court below held, with the burden of proof on taxpayer, it did not even establish that the specified two pictures actually produced any earnings and profits whatsoever in the two years in question, and there well may have been a loss[7] (R. 192). To meet the statu-

[7] The taxpayer agreed to pay the costs of production and was to receive all gross receipts (subject to the assignment

tory requirements, the contract must set forth expressly, that is, in unmistakable language, that it is dealing with a taxpayer's earnings and profits. Here, instead, it refers merely to the "proceeds" (R. 36) and to "gross receipts" (R. 41–42) of two particular assets belonging to a taxpayer. Dividends cannot be paid out of gross receipts which may, in fact, represent no profits at all, but loss. The title of subsection 26 (c) (2) shows that it refers to "Disposition of *profits* of taxable year." [Italics added.] Certainly the reasonable construction, in view of the purpose of the statute, of the term "earnings and profits" is that it means net "earnings and profits" of the corporation and not the gross receipts from an earmarked portion of its assets.

2. There is no conflict between the decision in this case and that of the Circuit Court of Appeals for the Fifth Circuit in *Scofield* v. *Valley Pipe Line Co.*, 138 F. 2d 835, although, as the court below observed, a "bald statement" contained in the opinion of the Fifth Circuit Court of Appeals is in disagreement with some of the reasoning of the court below (R. 194.) In the cited case, the obligation was to pay monthly 75 percent of the gross income of a pipe line, which was the taxpayer's "only source of income," and the actual

to Paley) above the distributor's share (R. 157–179). But the record shows that the amortization of the cost of production on these two pictures on December 31, 1935, had equalled the amount of proceeds paid over by the distributor or $469,939.32 (R. 123).

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credit allowed was limited to taxpayer's undistributed net income. 138 F. 2d at 836, n. 3. In substance, the court there found the contract to be as practically construed by the parties, and said (p. 837):

> Gross income of necessity includes whatever earnings and profits there are, and the facts of this case showing that the taxpayer did not pay the full 75 percent of gross income it had agreed to pay because it did not have that much earnings and profits available leaves in no doubt that the contract as drawn, as intended, and as executed, was a provision for the payment of earnings and profits within the statute.

Thus, premised on this construction of the contract, the court in the cited case deemed the Government's contention there—that the "payment out of 'gross income' could be made even if there were no earnings and profits"—to be "pure hypothesis" since (p. 837):

> The facts undisputed and found here are that included in gross income for the year in question were earnings and profits considerably in excess of the credit allowed, and that the parties in contracting understood that there would be.

The court thus indicated that its allowance there of the credit was due to the fact that the evidence showed specifically that the taxpayer's gross income included earnings and profits for the taxable

year in excess of the amount of the credit which was claimed, and that the parties, in contracting, understood that this would be true. Consequently, while it may seem that the court gave too liberal an interpretation to the contract there, it is evident that, even applying the test laid down in that case, the credit would not be allowed here. Unlike the cited case, taxpayer here has made no proof that the two pictures in question did produce any earnings and profits whatever; and, in the absence of such showing, we must assume that the gross receipts were from an enterprise conducted at no profit at all (R. 192). Thus, the facts in this case differ substantially from those in the *Scofield* case; they do not constitute decisions on the same matter, and despite the conclusory statement contained in the *Scofield* opinion, the respective decisions do not result in a conflict of circuits.

In its opinion, the court below refers to a number of decisions of the Board of Tax Appeals (R. 194), which taxpayer had cited and which also had been cited in the *Scofield* case.[8] All of these cases were decided before the decision of this Court in *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, *supra;* they are all distinguishable on their

[8] *Scofield* v. *Valley Pipe Line Co.*, *supra*, p. 837, note 6. The statement in the opinion there that "all of these decisions have been acquiesced in by the commissioner" is not correct.

facts and they fail to give adequate consideration to the rule of strict construction there laid down. In fact, in reasoning generally they relied upon such cases as *Commissioner* v. *Strong Mfg. Co.*, 124 F. 2d 360 (C. C. A. 6th), which was reversed in connection with the *Ohio Leather Co.* case. Indeed, one of them, *N. O. Nelson Co.* v. *Commissioner,* 45 B. T. A. 899, has itself been reversed on this ground by the Eighth Circuit Court of Appeals in *Helvering* v. *N. O. Nelson Co.,* 133 F. 2d 846, 850, certiorari denied, 319 U. S. 765.

3. No question important to the administration of the federal tax law is here raised. The provisions of Section 26 (c) of the Revenue Act of 1936 dealing with "contracts restricting payment of dividends" first appeared in that statute and were not continued in the Revenue Act of 1938 or in any subsequent Act. Accordingly, they apply only to income earned during the two years 1936 and 1937. Hence the question here relates strictly to a statute which has now been repealed almost seven years. Settlement of the question by this Court is not requisite in the public interest, for it is most unlikely that another similar case will come before the courts.

CONCLUSION

For the reasons above given, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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OCTOBER 1944.